

# SEBI's New Initiative: SEBI Board overhauls Settlement Mechanism, proposes amendments to PIT Regulations

October 9, 2018 | [\[2018\] 98 taxmann.com 98 \(Article\)](#)



## Introduction

1. In its board meeting held on September 18, 2018<sup>1</sup>, SEBI Board amended provisions relating to KYC requirement for FPIs and reviewed Total Expense Ratio of Mutual Fund Schemes. Other important decisions for the promoters and corporates were: (i) Reducing the time period for listing of issues, (ii) Amendment of Regulations relating to re-classification of promoter/public, (iii) Amendments to SEBI (Delisting of Equity Shares) Regulations, 2009, (iv) Framework for Enhanced Market Borrowings by Large Corporates, (v) Proposed SEBI (Settlement Proceedings) Regulations, 2018, (vi) Amendments to SEBI (PFUTP) Regulations and SEBI (PIT) Regulations to implement recommendations of the Committee on Fair Market Conduct. The SEBI Board approved amendment to SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 w.r.t. the disclosure requirement with respect to complaints under Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 in Corporate Governance. SEBI Board resolved to extend the requirements and disclosures in Business Responsibility Report to all listed companies. This article shows an analysis and compilation of the decisions taken by the SEBI Board at its meeting and its impact on the securities market.

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## KYC requirement for FPIs & Common Application Form for FPIs

2. The proposed KYC requirements and eligibility conditions for FPIs were discussed by the SEBI Board, in the light of the circular dated April 10, 2018 and the recommendations of the Khan Working Group. The proposed draft circular and proposed amendments to SEBI (FPI) Regulations, 2014 were discussed by the SEBI Board and broadly agreed upon. In relation to this, the SEBI issued Circular w.r.t. Eligibility conditions for FPIs ([Circular No. CIR/IMD/FPIC/CIR/P/2018/132, dated 21-9-2018](#)). SEBI also issued Know Your Client Requirements for FPIs ([Circular No. CIR/IMD/FPIC/CIR/P/2018/131, dated 21-9-2018](#)).

Honourable Union Finance Minister, while presenting the union budget for 2017-18, *inter-alia*, had announced Common Application Form (CAF) for FPIs. Accordingly, SEBI in consultation with Department of Economic Affairs, Ministry of Finance, Government of India, RBI and CBDT has

finalized a common application form for obtaining FPI Registration with SEBI, Permanent Account Number (PAN) and KYC for opening of bank and demat accounts by FPIs. The necessary amendments to SEBI FPI Regulations, 2014 will be made.

### **Review of Total Expense Ratio (TER) of Mutual Fund Schemes**

**3.** The SEBI Board observed that over a period of time, there have been varying practices in the Mutual Fund industry w.r.t. charging of expenses and payment of commissions. SEBI undertook an internal study to review TER. The analysis along with observations of the study was placed in a meeting of the Mutual Fund Advisory Committee ('MFAC'). The working group constituted by MFAC deliberated on the issues and submitted a report to MFAC. Upon deliberation on the findings of working group, MFAC made several recommendations on transparency in expenses, TER for various types of mutual fund schemes, investments through SIPs, limiting the additional incentives for B-30 cities based on inflows from retail investors, performance disclosure of Mutual Fund schemes, etc. The SEBI Board took note of the benefits of the proposal with respect to sharing of economies of scale, lowering the cost for mutual fund investors, bringing in transparency in appropriation of expenses, and reducing mis-selling and churning. Accordingly, the SEBI Board approved the following proposals:

- (i) *Transparency in Expenses:* All commission and expenses, etc., shall necessarily be paid from the scheme only and not from the AMC/Associate/Sponsor/Trustee, or any other route. Further, the mutual fund industry must adopt the full trail model of commission in all schemes without payment of any upfront commission or upfronting of any trail commission;
- (ii) *TER for schemes:* SEBI Board noted and approved the TER for open ended schemes (based on AUM Slab). SEBI Board also stated that the TER for equity oriented schemes shall be a maximum of 1.25% and for other than equity oriented schemes shall be a maximum of 1%. The TER for Index schemes, Exchange Traded Funds (ETFs) and Fund of Funds was also prescribed

It is a welcome step by SEBI as the investors will be benefitted from the transparent and cost-effective system. The lower expense ratio will have a positive impact on the returns, but over a period of time. This move coupled with mutual fund re-categorisation of mutual funds will bring in more transparency and cost-effectiveness.

### **Reduction in time-lines for listing of securities**

**4.** The SEBI Board has, in principle, approved the proposal of revisiting the public issue process by way of introducing the use of Unified Payment Interface (UPI) with facility of blocking the funds ('ASBA' facility), as a new payment mechanism for retail investor applications submitted through intermediaries. This is a significant process reform aimed at

reducing the time period for listing of issues from T+6 days to T+3 days. Under the new process, there will be no physical movement of retail investor application forms from intermediaries to Self-Certified Syndicate Banks. The modalities for implementation will be worked out in consultation with the stakeholders and the process will be implemented in a phased manner.

The compression in post-issue timelines and the consequent early listing and trading of shares will benefit both issuers as well as investors. Issuers will have faster access to the capital raised and the investors will have early liquidity. However, the timelines for securities market intermediaries will dynamically change. Though UPI with ASBA facility is an innovative step, the concern would be reaching investors in semi-urban and rural parts of India.

### **Amendment to Regulations relating to Re-classification of promoter/public**

5. The SEBI Board decided to revise the provisions relating to re-classification of promoter/public in a listed company. Such reclassification is subject to following conditions:

- (i) Promoter(s) seeking re-classification and persons related to them should not hold more than 10% of the total voting power or exercise control over the listed entity or have special rights in the company,
- (ii) Promoter(s) seeking re-classification and persons related to them should not be represented on the board of the listed entity or act as key managerial persons for a period of 3 years from such re-classification,
- (iii) Promoter(s) seeking re-classification and persons related to them should not be wilful defaulters.

The amendments to Regulation [31A](#) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 are aimed at liberalizing, streamlining and bringing about greater clarity in the framework. The revised process provides for application for reclassification by the promoter seeking, review by the company's Board and approval by the shareholders, with exiting promoters and related persons not allowed to vote. The provisions have been reviewed in light of the recommendations of Kotak Committee on corporate governance, feedback from stock exchanges and representations received.

### **Amendments to SEBI (Delisting of Equity Shares) Regulations, 2009**

6. The SEBI Board approved certain amendments to SEBI (Delisting of Equity Shares) Regulations, 2009 ('Delisting Regulations'). In case of voluntary delisting, if the price discovered through the reverse book building process is not accepted by the promoters, a counter offer can be given by the promoters. However, the price through the counter offer

should not be less than the book value and delisting will be successful only if such counter offer is accepted by such number of public shareholders that the post offer promoter shareholding reaches at least 90%. Further, as per existing Delisting Regulations, promoters of compulsorily delisted companies have to provide exiting option to the public shareholders. However, the existing regulations do not provide for any timeline for providing this exit option. SEBI Board has resolved to amend the regulations to provide that promoters will have to give the exiting option to public shareholders within 3 months of delisting from recognized stock exchange. The decision taken by the SEBI Board w.r.t. the exiting option to public shareholders within 3 months of delisting will ensure the time-bound process for the corporate action. The SEBI Board has also approved certain amendments, pursuant to a review carried out by an external expert, Shri. P.K. Malhotra (Former member SAT and Former Secretary, Ministry of Law and Justice). The review was aimed at simplifying the language, updating the references to the Companies Act, 2013/other new SEBI Regulations, and incorporating the relevant circular(s), FAQs in the Delisting Regulations, without making any substantive policy change.

### **Framework for Enhanced Market Borrowings by Large Corporates**

7. The SEBI Board considered and approved of the following framework for enhanced market borrowings:

- (i) Any large corporate, covered under the framework shall intimate to the stock exchange that they are covered under the framework and shall raise 25% of their incremental borrowings for that year through bond market;
- (ii) Any corporate, other than scheduled commercial bank, which has listed its specified securities or debt securities or non-convertible redeemable preference shares, and fulfils certain criteria, as on March 31st of a financial year, shall be categorized as large corporate under the instant framework;
- (iii) The term 'borrowings' wherever appearing in the framework shall mean the borrowings which have original maturity period of more than 1 year, i.e., only long-term borrowings. Further, such borrowings shall exclude external commercial borrowings, inter-corporate borrowings between a parent and subsidiaries;
- (iv) For initial 2 years of implementation of the framework, i.e., FY 2019-20 and FY 2020-21, a 'comply or explain' approach shall be applicable. Thus, in event of non-compliance, the reasons shall be disclosed as part of the 'continuous disclosure requirements' to Stock Exchanges;
- (v) From third year of implementation, i.e., F.Y. 2021-22, the requirement of 25% of incremental borrowing through bond market shall be tested for contiguous block of two years;
- (vi) At the end of 2 year block, if there is any deficiency in the requisite bond borrowing, a monetary penalty of 0.2% of the shortfall shall be levied;
- (vii) The said framework shall come into effect from April 1, 2019.

Crisil said in a note that the SEBI move could result in around Rs. 40,000-50,000 crore of additional corporate bond issuances over the next five years. The issues will depend on the investment climate in the country and trends in corporate bond and external commercial borrowings markets. Crisil's analysis shows 444 companies with aggregate rated long-term borrowings of around Rs. 45 lakh crore as of 2017-18 come in this category. However, around 210 of these 444 companies have already been sourcing at least a quarter of their funding needs from the corporate bond market. So, the remaining 234 would be the ones driving incremental issuances. At present, they hold only around Rs. 6 lakh crore of rated, long-term debt.

### **Proposed SEBI Regulations on Settlement Proceedings**

**8.** SEBI had constituted a High Level Committee under the Chairmanship of Justice A.R. Dave (Retd.) to, *inter alia*, review the existing Settlement Mechanism in SEBI. Public comments were sought on the report submitted by the Committee. After due consideration of the public comments and suggestions received, the SEBI Board approved the framing of SEBI (Settlement Proceedings) Regulations, 2018. The Regulations provide for settlement of proceedings under the securities laws by issuing a settlement order which shall include monetary terms and may also include non-monetary terms. The salient features of the regulations are as follows:

- (i) SEBI may not settle any proceeding if it is of the opinion that the alleged default has market wide impact, loss to investors or affects the integrity of the market,
- (ii) SEBI may not settle any proceeding where the applicant is wilful defaulter, fugitive economic offender or has defaulted in payment of any fees due or penalty imposed under securities laws.
- (iii) A new provision dealing with 'settlement with confidentiality' to any person that provides material assistance to the SEBI in its fact-finding process and proceedings have been specified,
- (iv) SEBI shall not consider an application for settlement, if an earlier application for the same alleged default has been rejected, or if the audit or investigation or inspection or inquiry is not complete (except in case of applications for confidentiality) or if recovery proceedings have been initiated,
- (v) Compounding applications shall be processed along the lines of settlement applications,
- (vi) SEBI may provide for issuance of a notice of settlement prior to issuance of a show cause notice for other defaults (other than in case of summary settlement),
- (vii) In the event of a settlement order being revoked on account of non-compliance with the terms of the order or not making full and true disclosures, the settlement amount paid shall not be refunded to the applicant.
- (viii) Procedure has been specified for the quorum of the meeting of the High Powered Advisory Committee. In case the recommendations of the High Powered Advisory Committee are

rejected, the panel of Whole Time Members shall record reasons for rejection of the recommendations.

SEBI Board has approved to overhaul the entire regulations relating to settlement proceedings. As approved by the SEBI Board, SEBI may not settle any proceeding if it is of the opinion that the alleged default has market wide impact, loss to investors or affects the integrity of the market. However, such phrases are quite wide - 'market wide impact', 'loss to investors', 'affects the integrity of the market'. SEBI Board has proposed a new provision for dealing with 'settlement with confidentiality' to any person that provides material assistance to SEBI in its fact-finding process and proceedings have been specified. The proposed provision is in the form of whistle-blower policy, however its implementation would be crucial. It is noteworthy that certain applications for settlement would not be considered, *e.g.* (i) If an earlier application for the same alleged default has been rejected, or (ii) If the audit or investigation or inspection or inquiry is not complete (except in case of applications for confidentiality) or (iii) If recovery proceedings have been initiated. In the interest of the stakeholders, this will reduce the scope of settlement proceedings.

The High Level Committee also suggested that the Central Government may be requested to amend the Income-tax Act, 1961, for removing the deduction as a business expense available for monies paid in pursuance of a composition or a settlement under the securities laws.

### **Amendments to SEBI (PFUTP) Regulations and SEBI (PIT) Regulations to implement recommendations of the Committee on Fair Market Conduct**

9. The SEBI Board considered the recommendations of the Committee on Fair Market Conduct and the public comments received thereon. The SEBI Board approved amendments to SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 2003 ('PFUTP Regulations') and SEBI (Prohibition of Insider Trading) Regulations, 2015 ('PIT Regulations') based on the recommendations of the Committee on Fair Market Conduct.

The amendments to the PFUTP Regulations relate to definition of 'dealing in securities' expanding the scope of the regulations to include employees and agents of intermediaries and strengthening of the deeming provisions for fraud to include activities such as misleading information on digital media, front running by non-intermediaries, mis-selling of securities and services related to securities, mis-utilisation of client account and diversion of client funds, manipulating bench mark price of securities, etc. On the issue of use of front entities or 'mule accounts' for engaging in fraudulent transactions and related recommendations on affordability index, it was decided to discuss this matter further with stakeholders.

Amendments to the PIT Regulations to include bringing further clarity on sharing of Unpublished Price Sensitive Information ('UPSI') for due

diligence or legitimate purposes, creation of database of persons with whom UPSI is shared, additional defences when trading in possession of UPSI, additional disclosures for aiding SEBI in investigations and introduction of framework for institutional responsibility to ensure that the institution takes responsibility to formulate a code of conduct and put in place an effective system of internal controls to ensure compliance with the various requirements specified in the PIT Regulation to prevent insider trading. On the issue of additional disclosures, considering public comments, the proposal for disclosure of name and PAN or equivalent identification of persons residing at the same address as the designated persons for a consecutive period of more than 1 year and disclosure of phone/mobile/cell numbers whose billing address is residence address of the designated person was dropped. With regard to applicability of Code of Conduct to designated persons as proposed to be defined, it was agreed that employees/CEO of associate companies may be excluded from the applicability of the Code of Conduct. On the recommendation that SEBI may seek direct power to intercept calls and electronic communication under the Telegraph Act, it was decided that the matter may be referred to the Government to take an appropriate view.

There are some significant amendments to the SEBI (PIT) Regulations, 2015. As per Regulation 3 of the said Regulations, no insider shall communicate, provide, or allow access to any UPSI, relating to a company or securities listed or proposed to be listed, to any person including other insiders. However, the said provisions are not applicable where such communication is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations. As per extant provisions, no person shall procure from or cause the communication by any insider of UPSI, relating to a company or securities listed or proposed to be listed. However, the said provisions are not applicable wherein such UPSI is procured in furtherance of legitimate purposes, performance of duties or discharge of legal obligations. Now, it is proposed to amend Regulation 3 of SEBI (PIT) Regulations w.r.t. sharing of UPSI. SEBI Board has approved the proposal of providing additional defences when trading in possession of UPSI. It will be interesting to see the fine-print w.r.t. the introduction of framework for institutional responsibility to ensure that the institution takes responsibility to formulate a code of conduct. As Regulation 9 of SEBI (PIT) Regulations state that the board of directors of every listed company and market intermediary shall formulate a code of conduct to regulate, monitor and report trading by its employees and other connected persons towards achieving compliance with these regulations, adopting the minimum standards. With regard to applicability of Code of Conduct to designated persons as proposed to be defined, SEBI Board has agreed that employees/CEO of Associate Companies may be excluded from the applicability of the Code of Conduct. The amendments will have an impact on the compliance of the SEBI (PIT) Regulations and the Insider Trading Policies.

### **Restrictions on Fugitive Economic Offenders**

**10.** The SEBI Board was informed of the following restrictions imposed by SEBI on fugitive economic offenders:

- (i) Restrictions on raising capital through IPOs on main board, rights issue, further public offers, preferential issue, Qualified Institutional Placement, IPO of Indian Depository Receipts, Rights issue of IDRs and IPO by Small & Medium Enterprises, if any of the promoter or director of the issuer is a fugitive economic offender.
- (ii) Restrictions on listing on ITPs and issue of bonus shares if any of the promoter or director of the issuer is a fugitive economic offender.
- (iii) Prohibition on making an open offer, counter offer or acquiring any shares or voting rights or control in a target company.

### **Enhanced disclosure requirements pertaining to Sexual Harassment of Women to all listed companies**

**11.** In order to strengthen disclosures relating to safety of women at corporate sector workplaces, amendments to Schedule V of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 have been approved to insert the disclosure requirement w.r.t. complaints under Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 in the Corporate Governance Report as part of Annual reports of listed entities. The disclosure relates to: (i) No. of complaints filed during the financial year, (ii) No. of complaints disposed off during the financial year, (iii) No. of complaints pending as at end of the financial year.

SEBI Board resolved to extend the requirements and disclosures in Business Responsibility Report to all listed companies.

### **12. Other important decisions taken by the SEBI Board**

- (i) *Review of requirement of 1% security deposit in public issues of debt securities:* Currently, 1% of the amount offered for subscription to the public is required to be deposited with the stock exchanges so that complaints relating to refund of application money, allotment of securities and dispatch of certificates etc. are resolved speedily. As the requirement of 1% security deposit imposes cost on issuer in case of public issue of debt securities and ASBA has been made mandatory mode of payment for application in case of such issues, SEBI Board approved the proposal of deleting the requirement of 1% security deposit from following certain Regulations, i.e., SEBI (Issue and Listing of Debt Securities) Regulations, 2008, SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013 and SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008;
- (ii) *Reduction in payment of regulatory fee by stock exchanges on turnover from agricultural commodity derivatives segment:* With an objective to promote agricultural commodity derivative segment and to ensure that the benefits of agricultural commodity derivative are passed on to the farmers and Farmers

Producer Organization, SEBI Board approved nominal regulatory fee at a flat rate of INR 1,00,000 per exchange (instead of levying regulatory fee at the prescribed turn-over based slab rates). In order to pass on the desired benefits from reduction of regulatory fees, SEBI Board proposed that exchanges dealing with agricultural commodities derivatives shall create a separate fund earmarked for the benefit of farmers/FPOs in which the regulatory fee forgone by SEBI shall be deposited and utilized exclusively for the benefit of and easy participation by Farmers and FPOs in the agri-derivatives market;

- (iii) *Draft framework for participation of Eligible Foreign Entities in the commodity derivatives market:* For opening up the commodity derivatives markets to the foreign participants, the SEBI Board approved the regulatory framework for permitting foreign entities having actual exposure to Indian commodity markets, to participate in the domestic commodity derivatives markets. Such entities would be classified as 'Eligible Foreign Entities' ('EFEs');
- (iv) *Inter-operability among Clearing Corporations:* SEBI Board also approved the amendments to Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 to enable interoperability among clearing corporations (CCPs), based on the recommendations of the Secondary Market Advisory Committee. The inter-operability among clearing corporations provides for linking of multiple CCPs. It allows participants to consolidate their clearing and settlement functions at a single CCP, irrespective of the stock exchange on which the trade is executed. It is envisaged that the interoperability would lead to efficient allocation of capital for the market participants, thereby saving on cost as well as provide better execution of trades.

## **Conclusion**

**13.** After a gap of 90 days from its earlier board meeting (June 21, 2018), the SEBI Board in its recently convened meeting (i.e., on September 18, 2018) took to significant decisions. These decisions have an impact on almost all participants of securities market i.e. retail investors, foreign investors, promoters of listed company, stock exchanges, bond market, agricultural commodity derivatives segment, commodity derivatives segment and compliance officers. From the perspective of promoters and corporate. Following decisions are important: (i) Amendment to Regulations relating to Re-classification of promoter/public, (ii) Framework for Enhanced Market Borrowings by Large Corporates, (iii) Amendments to SEBI (PFUTP) Regulations and SEBI (PIT) Regulations, (iv) Enhanced disclosure requirements pertaining to Sexual Harassment of Women.

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[1](#) SEBI Press Release No. 41 / 2018, dated September 18, 2018